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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1941

No. [REDACTED] 110

W. E. RICHARDSON, IN HIS OWN RIGHT AND AS TRUSTEE,  
AND OTHERS,

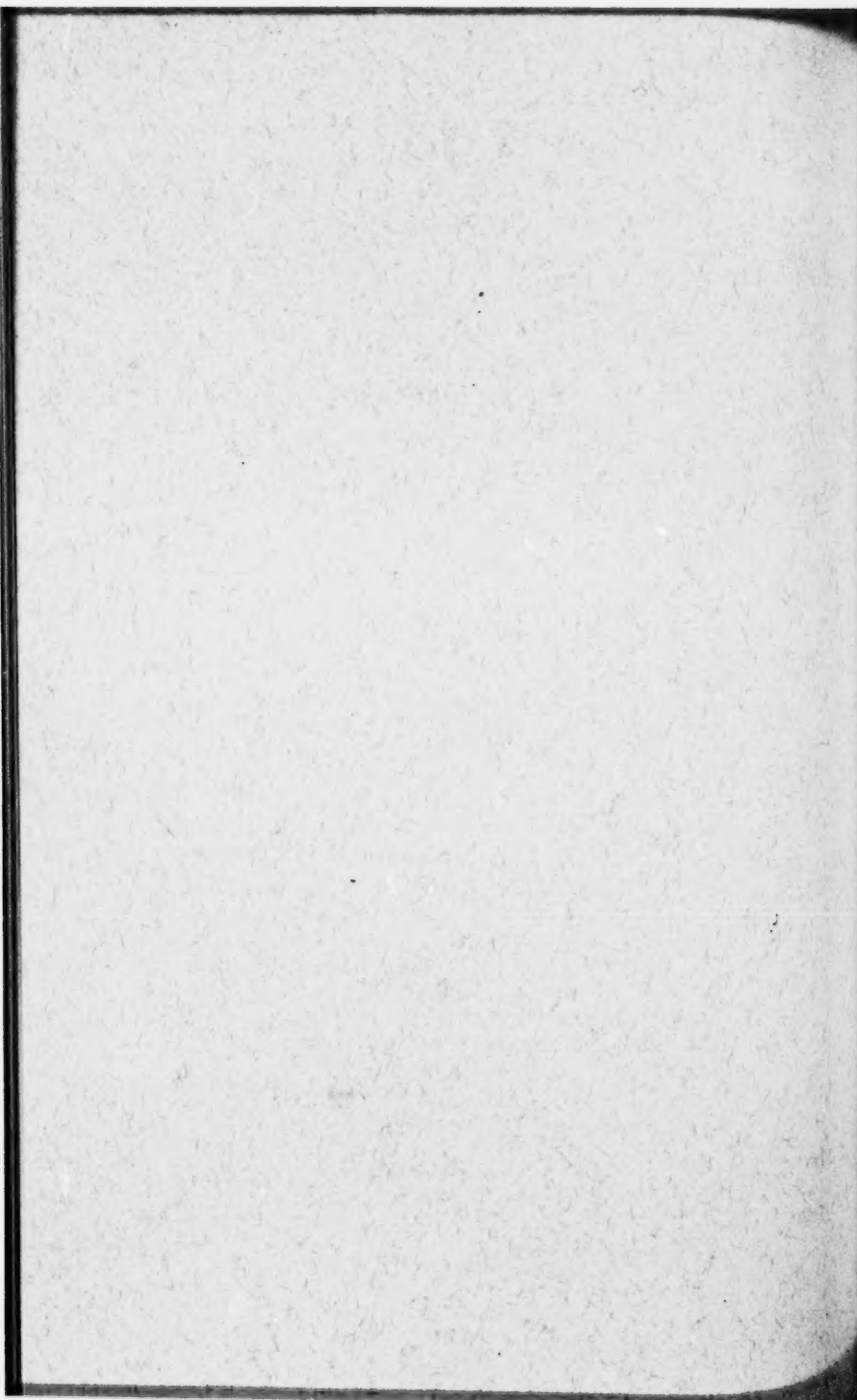
*Petitioners,*

*vs.*

BLUE GRASS MINING COMPANY AND OTHERS.

PETITION FOR WRIT OF CERTIORARI TO THE  
UNITED STATES CIRCUIT COURT OF APPEALS  
FOR THE SIXTH CIRCUIT AND BRIEF IN SUP-  
PORT THEREOF.

BAILEY P. WOOTTON,  
WM. ERNEST FAULKNER,  
A. B. BOWMAN,  
J. R. SIMMONDS,  
*Counsel for Petitioners.*



# INDEX.

## SUBJECT INDEX.

	Page
Petition for writ of certiorari.....	1
Summary of the matters involved.....	2
Statement of the case.....	3
Findings and decree of courts below.....	8
Jurisdiction and reasons for invoking.....	9
Question for decision.....	10
Probable errors.....	11
Conclusion.....	12
Brief in support of petition.....	13
Opinion of lower court.....	13
Findings of fact in the lower courts relied upon..	13
Statement of case (see petition).....	14
Probable errors and questions presented (see petition).....	14
Jurisdiction.....	14
Argument.....	15
By applicable decisions of Kentucky, as well as by the weight of authority of other cir- cuits and of this Court, trustees guilty of wilful fraudulent breach of trust, and who denounce their trust and seek to appropriate the trust estate to themselves, should be denied all compensation for services.....	15
The opinion and decree of the courts below permitting the respondent trustees to hold the stock of Black Gold Mining Company are probably contrary to the decisions of this Court, the courts of other circuits including the Sixth Circuit, and to the weight of authority.....	24

## TABLE OF CASES CITED.

<i>Barney v. Saunders</i> , 16 How. 542, 14 L. Ed. 1050.....	16, 28
<i>Backus v. Finklestein</i> , 23 F. (2d) 357.....	16, 29
<i>Boyd v. Boyd</i> , 3 Grath 113.....	16

	Page
<i>Caldwell v. Hicks</i> , 15 Fed. Supp. 46.....	16
<i>Cominger v. Louisville Trust Co.</i> , 128 Ky. 697, 108 S. W. 960, 111 S. W. 681, 129 Am. St. Rep. 322.....	15
<i>Davis v. Swedish Am. Nat. Bank</i> , 78 Minn. 408, 80 N. W. 953, 81 N. W. 210, 79 A. S. R. 400.....	16
<i>Drury v. Milwaukee etc. S. R. Co.</i> , 7 Wall. 299, 19 L. Ed. 40.....	29
<i>Erie R. Co. v. Tompkins</i> , 304 U. S. 64, 82 L. Ed. 1188..	9, 15
<i>Flint River Pecan Co. v. Fry</i> , 39 F. (2d) 457.....	16
<i>Garesche v. Levering Co.</i> , 146 Mo. 436, 48 S. W. 653, 46 L. R. A. 232.....	23
<i>Geddes v. Anaconda Copper Min. Co.</i> , 254 U. S. 590, 65 L. Ed. 425.....	29
<i>Highland Cotton Mills v. Rayon Knitting Mills</i> , 194 N. E. 88, 138 S. E. 431.....	29
<i>Hodges Estate, In re</i> , 66 Vermont 70, 44 A. S. R. 820..	17
<i>Hollins v. Brierfield Coal &amp; I. Co.</i> , 150 U. S. 371, 14 Sup. Ct. Rep. 127, 37 L. Ed. 1113.....	28
<i>Jackson v. Ludeling</i> , 21 Wall. 616, 22 L. Ed. 492.....	28
<i>Kline, In re</i> , 280 Pa. St. 41, 124 Atl. 280, 32 A. L. R. 926..	17
<i>Koehler v. Black River Falls Iron Co.</i> , 2 Black 715, 17 L. Ed. 339.....	28
<i>Lewis v. Ingram</i> , 57 F. (2d) 463.....	16
<i>Meinhard v. Salmon</i> , 249 N. Y. 458, 164 N. E. 545, 62 A. L. R. 1.....	30
<i>Munro v. Smith</i> , 259 Fed. 1.....	16
<i>Paducah Land etc. Co. v. Hayes</i> , 15 Ky. L. R. 517, 24 S. W. 237.....	23
<i>Polansky, In re</i> , 41 F. (2d) 547.....	16
<i>Richardson v. Blue Grass Min. Co.</i> , 39 Fed. Supp. 658..	7
<i>Turner v. Ryan</i> , 272 N. C. 60, 110 A. L. R. 554.....	17
<i>Twirl-Lick Oil Co. v. Marbury</i> , 91 U. S. 587, 23 L. Ed. 328.....	28
<i>Wadsworth v. Adams</i> , 138 U. S. 380, 34 L. Ed. 984....	16
<i>Walker v. Beal</i> , 9 Wall. 743, 19 L. Ed. 814.....	16
<i>Ward v. Funston</i> , 86 Va. 359, 10 S. E. 415.....	16
<i>Wardell v. Union P. R. Co.</i> , 103 U. S. 651, 26 L. Ed. 509..	28
<i>Weakly v. Merriweather</i> , 156 Ky. 304, 160 S. W. 1054..	16
<i>Webster Loose Leaf Filing Co., In re</i> , 252 Fed. 959....	29
<i>Wright v. Kentucky etc. G. E. R. Co.</i> , 117 U. S. 72, 6 Sup. Ct. Rep. 697, 29 L. Ed. 821.....	29

STATUTES CITED.

	Page
Act of March 3, 1891, 26 Stat. 828, as amended.....	14
Judiciary Act of Sept. 24, 1789, Sec. 34, Ch. 20, U. S. C. A. 725.....	9
U. S. C. A., Title 28, Section 347 as amended.....	9, 14

TEXTS CITED.

65 C. J., p. 929, Sec. 840.....	24
Restatement of the Law of Trusts, Sec. 243, sub-sec. d. .	17



SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1941

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**No. 1274**

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W. E. RICHARDSON, IN HIS OWN RIGHT AND AS TRUSTEE,  
AND OTHERS,

*Petitioners,*

*vs.*

BLUE GRASS MINING COMPANY AND OTHERS.

---

**PETITION FOR WRIT OF CERTIORARI TO THE  
UNITED STATES CIRCUIT COURT OF APPEALS,  
SIXTH CIRCUIT.**

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*To the Honorable Supreme Court of the United States:*

This suit is prosecuted by petitioners alleging themselves to be stockholders of Blue Grass Mining Company and Pendleton Store, Inc., against the corporations and their managing and controlling officers, directors and stockholders, for an accounting on behalf of the corporation, and all stockholders, of funds allegedly taken, converted and used by such managing and controlling individuals, and for the recovery of property acquired by them in their own names with corporate funds.

Another aspect of the suit was to establish the quantum of petitioners' holdings in said corporations. From the action of the Trial Court decreeing petitioners a 50% interest in the corporations and awarding judgment on certain items of accounting, respondents appealed to the Circuit Court of Appeals, and from the action of the Trial Court in denying petitioners' claims on certain items of accounting including those herein mentioned, petitioners took a cross-appeal.

Opinion of the District Court rendered October 17, 1939, is published in 29 Fed. Supp. p. 658, and appears in the record Vol. I, at p. 358, the findings of fact in R. I. p. 385, and decree entered August 1, 1940, in R. I. p. 417.

The Court of Appeals affirmed, March 2, 1942, (R. VI. p. 2183).

## I.

### **Summary of the Matters Involved.**

Certain individual defendants, J. E. Johnson, Sr., J. E. Johnson, Jr., Wm. Pendleton and Arch Pendleton (known in the record as the "Kentucky Group"), undertook to appropriate to themselves all of the capital stock of two Kentucky corporations, Blue Grass Mining Company and Pendleton Store, Inc., notwithstanding the right of petitioners (since adjudicated below) to one-half thereof, and proceeded to elect themselves directors and officers of said corporations, and assumed and exercised sole and exclusive management and control thereof, voting to themselves large salaries or bonuses, lending to themselves or to other corporations owned and controlled by them, large sums of money, and financing and promoting new enterprises and corporations with the corporate funds, taking title in their own names to property bought with corporate funds, and doing various other acts to their own interest and to the detriment of the interests of the corporations. The ques-

tion involved is whether or not managing and controlling directors and officials of corporations guilty of such fraudulent conduct will be denied all compensations for acting in their trust capacity, and be required to disgorge the stock of corporations promoted by them with the trust funds, all as insisted by petitioners, or whether they may, in equity, be allowed "reasonable" compensation for their services, and permitted to keep at least a part of the fruits of their illicit investments, as held by the lower courts.

We submit that substantially every material fact to support petitioners' insistence under the law, was found by the Trial Court and approved by the Circuit Court of Appeals, and we therefore shall not question the findings of facts, but shall rely thereupon in support of this petition. Since the facts are fully found by the Trial Court, concurred in on appeal and not now challenged (See Opinion, 29 Fed. Supp. 658; R. I. p. 358, and Findings of Fact R. I. p. 385), it would seem to be necessary here only to epitomize said opinion and findings in so far as material to the issue here raised.

## II.

### Statement of the Case.

So far as necessary to a consideration of the questions here involved the facts may be stated as follows:

In December, 1929, the Kentucky group acting in the name of J. E. Johnson, Sr., entered into a contract with the petitioners, known in the record as the "Tennessee Group", acting then in the name of M. T. McArthur, Trustee (later succeeded by W. E. Richardson, Trustee), under which the Tennessee Group acquired a 50% interest in a bid then pending and unconfirmed, on a certain coal mine and equipment, and a certain commissary stock of merchandise and fixtures, in the State of Kentucky, and also

under which the two groups were to join in the formation of two corporations to operate said properties and venture and to receive the titles, each group to own 50% of the stock of the corporations (R. I. 53). The bid was confirmed in the court in which the sale was ordered and the corporations were chartered, the members of each group subscribing to 50% of the stock (R. II, pp. 1-12; 44-46; 218-19; 320-21; R. III, pp. 762-65). The Tennessee Group put up their share of agreed working capital (R. II, 82; 320-23). However, no certificates of stock in the corporations were ever issued. The corporations went into possession of the properties and immediately began successful operations. The Kentucky Group, two of whom, J. E. Johnson, Sr., and J. E. Johnson, Jr., were lawyers, held the organization meetings of the corporations in December 1929, and January 1930, and unknown to the Tennessee Group, attempted to allocate the entire capital stock to themselves, in violation of the subscription agreements, and elected themselves sole directors and officers, without furnishing any minutes or records of the meeting to the Tennessee Group, or giving them any information other than that an organization meeting had been held (R. II, pp. 4-6; 80-81; R. VI, pp. 1812-20). In the summer of the year 1930, the Kentucky Group again unknown to petitioners, purported to pay for this stock by entry of accounts on the books in their favor as alleged salaries and charging these with alleged payments for stock. The original sale of the coal properties was reversed on appeal in May, 1930, but the corporation remained in possession under an interim lease with the receiver, and at the second sale held in the autumn of 1930, the coal properties were purchased for the Blue Grass Mining Company, which paid for them after the second bid and sale was affirmed on appeal. The original sale of the commissary stock of merchandise and fixtures was never reversed.

In February, 1931, the Tennessee Group were induced by fraudulent representations of the Kentucky Group, to sign, through their representative, W. E. Richardson, Trustee, a purported agreement the effect of which would have been to reduce their stock interest in the corporations from 50% to 30% (Findings of Fact 22-23, R. I, p. 391).

The Tennessee Group kept in touch in a general way with the enterprise, but were not furnished statements, and knew nothing of the financial matters. Repeated requests to the Kentucky Group by the Tennessee Group to issue the stock of the corporations being invaded, the Tennessee Group demanded an audit, which, though at first resisted, was finally made in 1935. This audit revealed that the Kentucky Group had consistently used the funds of the corporations to promote their own interests and affairs, some of which had been paid back with interest, most of it without interest, and some not at all; that they had by the aid of corporate funds acquired property in their own names adverse to the interests of the corporation, and that they had withdrawn under the guise of salaries to themselves, practically the entire corporate earnings (R. I, p. 390).

At the first and only stockholders meeting ever called and held on February 8, 1936, the Tennessee Group complained that their entry into the alleged contract of February 18, 1931, reducing their stock interest to 30% in the corporations had been fraudulently induced, and demanded to participate as owners of 50% of the stock. The Kentucky Group demanded that they participate as owners of 30% of the stock or leave the meeting. The Tennessee Group did the latter, and filed this suit on the theory that they were the undisputed owners of 30% of the stock of the two corporations, and claiming to be the rightful owners of 50% of the stock, and also seeking an accounting on behalf of the corporations and all stockholders, with the

Kentucky Group constituting their officers and directors (R. I, pp. 1-53, 137, 144, 152, 182, 255, 326, 332, 391-2). The Kentucky Group answered for themselves and the corporations denying that petitioners, the Tennessee Group, were entitled to the ownership of any of the stock of either of the corporations, or were entitled to an accounting (R. I, pp. 102, 157, 164, 211, 285, 339, 348).

Among other illegal acts the Kentucky Group loaned to themselves, or to a corporation organized by them, labor, material, and money to the extent of thousands of dollars to start another coal mining operation under the name of Black Gold Mining Company, on lands adjoining Blue Grass Mining Company properties, mining the same seams of coal, and entering a competitive market with Blue Grass coals. The Kentucky Group put little, if any money into this proposition, though they borrowed some money for it, to be repaid on a per ton basis, which together with Blue Grass Mining Company money, financed it. This Black Gold Mine proved a profitable enterprise from the beginning, and members of the Kentucky group repaid the money which they borrowed for it from its earnings, and drew large sums as salaries therefrom at the same time they were drawing large sums from Blue Grass Mining Company and Pendleton Store, Inc., under the guise of salaries (R. I, pp. 399-400).

Had the Kentucky Group been working in the interest of Blue Grass Mining Company instead of their own interest, this Black Gold property would have been acquired in its name instead of theirs. The properties adjoin the Blue Grass properties and carry the same seam of coal (R. III, pp. 616-17). The coal is sold in the same market and office, buying and selling facilities are shared (R. III, p. 753; R. IV, pp. 1098-9, 1203-6; R. V, pp. 1523-27). They have a common executive and supervisory management and are operated practically as one property, except the profits

go to different sources. The property would have been advantageous to Blue Grass, respondent Johnson, Sr., testifying that one reason for its organization was that Blue Grass needed additional tonnage for efficient conduct of its sales facilities (R. VI, p. 1749).

The Kentucky Group were guilty of many other acts of misconduct and breach of trust, too numerous to mention here.

In that phase of their suit on behalf of the corporations and all stockholders, against said Kentucky Group, petitioners, among other things sued (1) to compel the members of the Kentucky Group as recreant trustees, to refund to the treasuries of the Blue Grass Mining Company and Pendleton Store, Inc., the funds withdrawn by them as alleged salaries, and (2) to require them to issue to Blue Grass Mining Company the stock of Black Gold Mining Company, and its subsidiary holding company, Jeda Coal Company, because said last named corporations had been financed with Blue Grass Mining Company funds.

The first of these prayers was granted in part, the trial court requiring a part of the so-called salaries to be refunded to the corporate treasuries, that although the members of the Kentucky Group would be required to make restitution for their fraudulent breach of trust, they would not be penalized by denial of compensation, and would be allowed reasonable salaries. As to the second proposition, the trial court held that, although the use of the trust funds by the Kentucky Group in promoting Black Gold Mining Company was wrong and indefensible, the money was repaid and the Company sustained no loss, and, therefore, the Kentucky Group should be allowed to keep this property and the salaries they had drawn therefrom (R. 339-400).

See *W. E. Richardson v. Blue Grass Min. Co., et al.*, 29 Fed. Supp. 658 (R. I, p. 358).

The Circuit Court of Appeals affirmed the decree of the District Court, without opinion (R. VI, p. 2183).

### III.

#### **Findings and Decree of Courts Below.**

The action of the District Court, affirmed by the Court of Appeals, which forms the basis of petitioners' complaint here, may best be illustrated and most succinctly presented by the two quotations following from the findings of fact and conclusions of law by the learned trial Judge, pursuant to which decree was entered, to-wit:

“While the members of the Kentucky group have been guilty of fraudulent breach of trust in using the funds of the affiliated corporations to finance various corporations and enterprises organized or promoted by them, in the purchase of property necessary or advantageous to the corporations for their personal gain and enrichment, in denying to Blue Grass Mining Company title to properties purchased by or for it and paid for by it, in attempting to appropriate to themselves all the capital stock of Blue Grass Mining Company, Pendleton Store, Inc., and Blue Grass Coal Company, and in attempting to exclude complainants as rightful and bona fide stockholders of Blue Grass Mining Company and Pendleton Store, from all interest in or benefit of the corporations and their assets, and in other questionable transactions, for these derelictions the Court will require full restitution, and equity does not demand that they be denied reasonable compensation for their services. There is room for judicial discretion. I conclude therefore, that reasonable compensation for services of the Kentucky group for the period ending March 1, 1937, would be: J. E. Johnson, Sr., \$5000.00 per annum, or a total of \$35,833.32; William Pendleton \$4,800.00 per annum, or a total of \$34,400.00; J. E. Johnson, Jr., \$2,400.00 per annum, or a total of \$17,200.00; Arch Pendleton \$3,000.00 per annum, or a total of \$21,500.00.” (R. I, p. 416.)

“With the aid of funds and credits advanced by Blue Grass, Black Gold became an operating company and began shipping coal in January or February, 1931, before any funds were put into it by its organizers and stockholders in March and April, 1931. From the operation of the business of Black Gold and Jeda Companies, J. E. Johnson, Sr., J. E. Johnson, Jr., and Wm. Pendleton, received substantial annual salaries. Such use of the assets of Blue Grass Mining Company was clearly wrong and indefensible, but the evidence shows that for all services rendered and credit extended to Jeda and Black Gold, Blue Grass Mining Company has been fully paid and that all loans or advancements made have been repaid with interest. While it is true that the aid received from Blue Grass Mining Company was a substantial advantage to the Kentucky group in promoting their interests in Black Gold and Jeda, the claim that these corporations were financed entirely by Blue Grass Mining Company is not sustained by the evidence. Blue Grass Mining Company appears to have suffered no actual loss on account of any of these transactions.” (R. I, p. 400.)

Other findings are pertinent, but the above quotations present the issue clearly and in the shortest possible space.

#### IV.

##### **Jurisdiction and Reasons for Invoking.**

Jurisdiction of this Court is invoked under U. S. Code Annotated, Title 28, Section 347, as amended by the Act of February 13, 1925, C. 226, Sec. 1, 43 Stat. 938; Jan. 31, 1928, C. 14, Sec. 1, 45 Stat 54; June 7, 1934, C. 426, 48 Stat. 926, Rule 38 Sub. Sec. 5(b), and Sec. 34 Judiciary Act of Sept. 24, 1789, Ch. 20, U. S. C. A. 725, and *Erie R. Co. v. Thompkins*, 304 U. S. 64, 82 L. Ed. 1188.

The reasons for invoking the jurisdiction of this Court are three fold.

First: That the common law of Kentucky concerning compensation of trustees, as determined by the highest court of that state, may be applied.

Second: That there may not result from the opinion of the District Court (29 Fed. Supp. 658), and decree thereon, and from the decree of the Circuit Court of Appeals affirming same, any confusion in or modification of the repeated decisions of other Circuit Courts of Appeals, and of this Court to the effect that a Trustee found guilty of wilful and fraudulent breach of his trust will not be allowed compensation or be permitted to keep the gains from his fraudulent manipulation of the trust funds.

Third: that there may be no deviation from or weakening of the rule, repeatedly announced by this and other courts, that one who gains through the wilful and fraudulent misuse of trust money and property will be required to disgorge his illegal gains and be penalized by denial of compensation. This rule is so fundamental to business and civic morality and to the preservation of society itself, that its slightest relaxation, even in matters of private enterprise, must be charged with a public interest.

## V.

### Questions for Decision.

We, therefore, present to this Court for decision but two questions, to-wit:

(1) Whether or not managing and controlling directors and officers of a Kentucky corporation, administering their trust in Kentucky, who are found to be guilty of wilful and fraudulent breach of trust imposed upon them by law as such, and who finally denounce their trust and seek to appropriate to themselves the entire trust estate, are entitled to any compensation, under the applicable law

of Kentucky, or the law as announced by this Court and the courts of other Circuits.

(2) Whether or not officers of a corporation who have used the funds and credit of the corporation to acquire other property, the ownership of which would be advantageous to the corporation, and have wilfully and wrongfully used the credit of the corporation to promote and organize corporations for the exploitation of the property so acquired, are entitled to the ownership of the property so acquired, and the stock in the corporations so organized, as between them and the parent corporation so entrusted to them.

## VI.

### **Probable Errors.**

We submit that the Courts below probably erred in the application of the law to the facts as found. According to the opinion and findings of the learned trial Judge, equitable principles had to be called in to extricate the guilty trustees from the position in which their misconduct has placed them. Equity is a protection for the innocent and should never be a shield for the wrongdoer. Therefore, the probable errors consist in

(1) Failure to give effect to the applicable Kentucky law as to compensation for trustees guilty of wilful and fraudulent breach of trust.

(2) Allowing "reasonable" or any compensation to trustees guilty of wilful fraudulent misconduct, and who attempt to appropriate to themselves the entire property entrusted to them, and who, in the final accounting, denounce their trust.

(3) In allowing such trustees to hold property acquired by the use of trust funds, which property would be advan-

tageous to the trust estate or would be harmful in the hands of strangers to the trust estate.

(4) In resorting to the aid of equity to extricate the wrongdoers from the difficulties in which they had placed themselves.

WHEREFORE your petitioners respectfully pray that a writ of certiorari issue out of and under the seal of this Honorable Court, directed to the United States Circuit Court of Appeals, Sixth Circuit, commanding that Court to certify and send to this Court for its review and determination on a day certain to be therein named, a full and complete transcript of the record and all proceedings in the case numbered and entitled on its docket Blue Grass Mining Company et als., Appellants and Cross-Appellees, v. W. E. Richardson, Trustee, etc., et als., Appellees and Cross-Appellants, numbers 8870-8871; that the judgment of the said Circuit Court of Appeals may be reversed by this Honorable Court, and that petitioners may have such other and further relief in the premises as may seem meet and just. And Petitioners will ever pray.

W. E. RICHARDSON, Trustee, etc., et als.,  
Cross-Appellants, *Petitioners*,

By BAILEY P. WOOTTON,  
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